In the Supreme Court of the United States

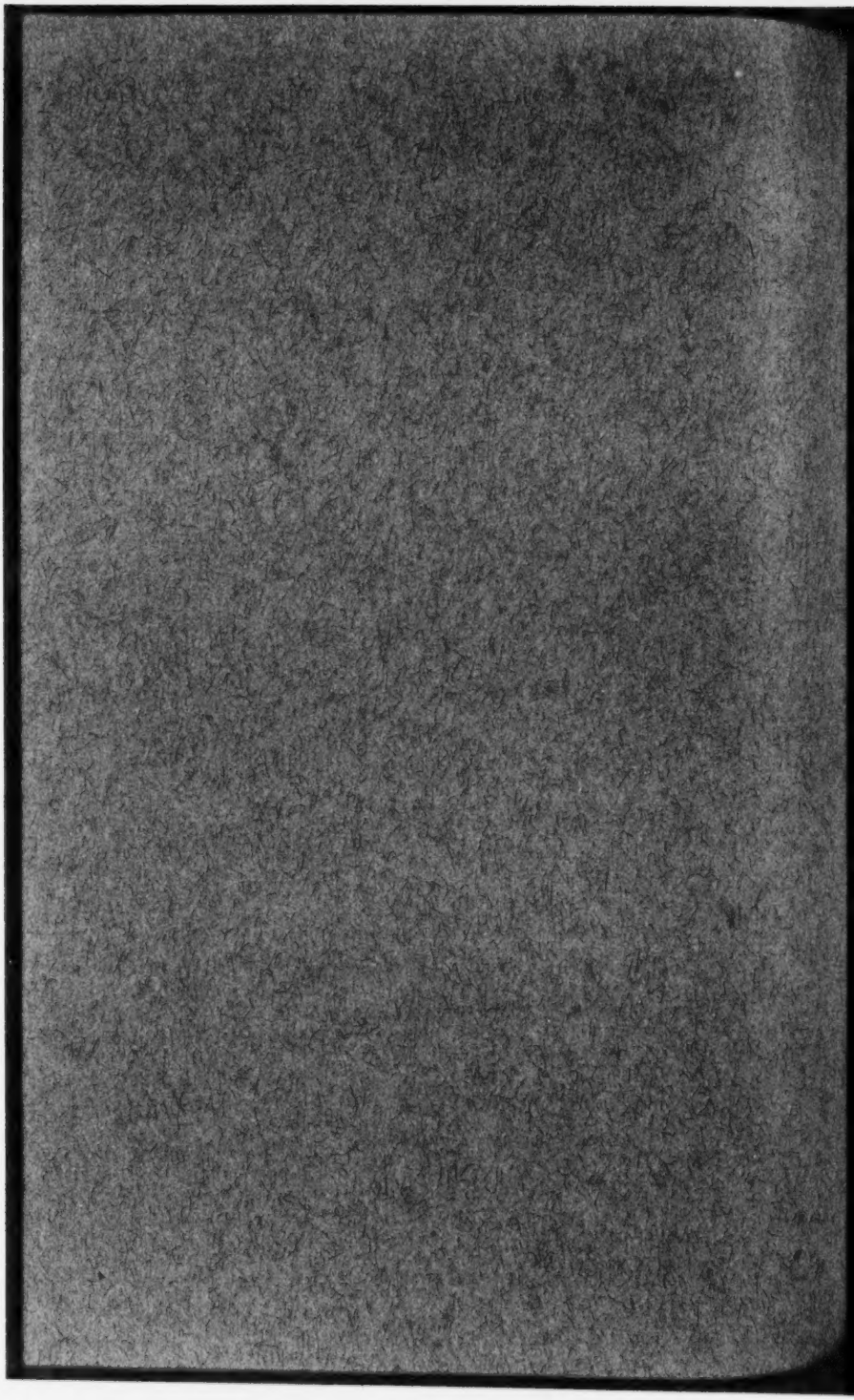
October Term, 1942

No. [illegible]

GUY T. [illegible]

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

BRIEF FOR THE [illegible]



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465151—42

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 88

NEBO OIL COMPANY, TRUST, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13–20) was not reported. The opinion of the Circuit Court of Appeals (R. 72–77) is reported in 126 F. (2d) 148.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 18, 1942 (R. 77–78). A petition for rehearing (R. 81–86) was denied on March 24, 1942 (R. 87). The petition for a writ of certiorari was filed May 11, 1942. The jurisdiction

of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Nebo Oil Company was an association taxable as a corporation within the meaning of Section 801 (a) (2) of the Revenue Act of 1934 and Section 1001 (a) (1) (2) of the Revenue Act of 1936.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 10–14.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 14–18) and the Circuit Court of Appeals (R. 72–76) may be summarized as follows:

In 1928, W. H. Clement, D. Replogle, and William G. Johnston acquired an oil and gas lease, known as the Nebo-Little lease. Each contributed one-third of the cost of the lease and acquired a one-third interest therein. Title was taken in the name of Clement, who held it as trustee for himself and his associates. From 1928 to 1932, Clement and his associates attempted without success to dispose of the lease. By 1932, because of adjacent offset developments, the lessor demanded development of the lease and threatened cancellation if drilling operations were not begun

immediately. In view of the threatened cancellation, a contract was entered into with a drilling company in 1932 (R. 14–15).

On December 12, 1932, while this well was in process of drilling and in anticipation of production, Clement executed a trust agreement conveying the lease to himself as trustee. The instrument declared Replogle, Johnston, and Clement to be the beneficiaries, each to the extent of a one-third interest. The trustee was given broad powers of management with full authority to operate the lease, to sell the oil and gas produced thereon, to collect the funds of the trust and distribute them among the beneficiaries, to begin and defend legal proceedings, to sign division orders, to convert any property of the trust and distribute or retain the proceeds, to invest the trust's funds, or trade or exchange the trust's properties, and to do all other things necessary for the (R. 15–16)—

> promotion of the welfare of this fiduciary trust estate, and the accomplishment of the purposes above stated, with as full discretionary power and authority vested in said trustee as he would have if he were the sole and absolute owner of said property in fee simple * * *.

In the event of the resignation or incapacity of the trustee, a new trustee was to be appointed by any two of the beneficiaries. The liability of the beneficiaries on account of any contract or tort

was to be limited to the funds and property of the trust. No beneficiary was to be "personally liable as a partner or principal or otherwise", on account of such contracts or torts. The interests of the beneficiaries were made transferable upon notice to the trustee, but no transfer of a partial interest was permissible. Transferees were to be bound by the terms of the trust and all acts performed thereunder (R. 15–16, 49–50, 73–74).

The trust was administered at the office used by the associates. It issued no trust certificates, had no officers or seal, and held no regular meetings. It had no employees other than those who worked on the leasehold. The trustee on his own responsibility dispatched all matters of routine business, but on questions of policy, such as the drilling of new wells, consulted with the other two beneficiaries. The original contribution of the beneficiaries to the trust in cash was $100. During the period from 1932 to 1934, Replogle and Clement made advances to the trust in cash and guaranteed contracts, bank loans, and trading accounts, in the amount of $90,000 (R. 16).

The first well was completed on December 15, 1932, and during the next 18 months three additional wells were drilled. No additional wells were drilled during the taxable years, 1934 to 1937, inclusive (R. 16, 18). On October 7, 1933, an oil and gas lease, known as the Odebrecht lease, was conveyed by Clement to the taxpayer. This conveyance was made at a time when it became neces-

sary to begin development of the lands covered by the lease (R. 17).

On November 10, 1933, at the request of the beneficiaries, Clement, as trustee, executed an instrument limiting his powers as trustee. It provided that the trustee would make an annual accounting to the beneficiaries; that he would not reinvest the trust funds except in the improvement, development and operation of the leasehold estate then owned by the trust; and that the cash surplus would be annually distributed to the beneficiaries, except that the trustee should retain such sum as he should deem to be reasonably necessary for future expenditures on the lease property, for maturing obligations, and as a prudent surplus against unforseen injury to the lease (R. 17, 54–55, 74).

On February 14, 1935, the trust instrument of December 12, 1932, was further modified by a written instrument. It provided that the trustee should furnish quarterly statements of income and disbursements to each beneficiary, and, after payment of operating expenses and indebtedness, should disburse the net profits quarterly to the beneficiaries; that the trustee should not have power to purchase real property or other leaseholds, but that he should not be restricted in purchasing supplies and equipment necessary to operate the trust property; that he should not have the power to sell or mortgage any part of

the trust leaseholds; and that he should not have the power to drill additional wells on those properties (R. 17, 56–57, 74–75).

The Nebo-Little and Odebrecht leases were the only leases acquired by the taxpayer. It owned no other properties. The funds received by it from oil production were either applied to the costs of further development of the leases or were distributed to the beneficiaries. During the taxable years 1934 to 1937, inclusive, there was no transfer of the interests of the beneficiaries nor any attempt to sell beneficial interests. The taxpayer during each of the taxable years realized net income from oil production which was distributed to the beneficiaries (R. 17–18).

The taxpayer reported its income for the taxable years as a fiduciary, showing distribution thereof to the beneficiaries, who returned the distributions in their taxable income. The taxpayer filed capital stock tax returns and paid taxes thereon for the years 1934 to 1937, inclusive. Suit for refund of these taxes was pending at the time of the hearing before the Board (R. 18).

The Commissioner determined that the taxpayer was an association taxable as a corporation and proposed deficiencies accordingly (R. 9–10, 13). The Board of Tax Appeals held that the taxpayer was a trust and not taxable as a corporation (R. 18–20). The Circuit Court of Appeals reversed (R. 77).

ARGUMENT

The court below correctly ruled that the petitioner was taxable as an association rather than as a pure trust. The decision is in accord with the decisions of this Court, and there is no occasion for further review.

The taxpayer had those features which ordinarily characterize an association: centralized management of a business enterprise; continuity of the enterprise for the benefit of the equity owners, which was free from termination or interruption through the death of either a beneficial owner or the trustee; transferability of the equity interests, without affecting the continuity of the enterprise; and limitation of personal liability. *Morrissey* v. *Commissioner,* 296 U. S. 344; *Swanson* v. *Commissioner,* 296 U. S. 362; *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369; *Helvering* v. *Combs,* 296 U. S. 365.

The taxpayer's principal contention is that the court below was without power to review the Board's conclusion that the taxpayer was a pure trust. But there is no disputed question of fact in this case, the sole issue being whether the taxpayer was an association as a matter of law. The court below had full power to consider that question, and, indeed, this Court reversed both the Board and a circuit court of appeals in *Helvering* v. *Combs,* 296 U. S. 365, on just such an issue. The *Combs* decision is therefore conclusive that the

question is not one of fact and is open to reexamination by an appellate court.

The Board's decision in this case rested largely upon the supposed purpose in creating the trust as one to define the rights of the parties, with the corollary that the trustee was merely a disbursement and collection agent. But that conclusion was tantamount to a holding that the motive for uniting to form an entity possessing corporate attributes may prevent the entity from being an association—a holding that was directly contrary to *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369, 373–374. Thus, even though the question whether a particular organization is an association may not normally be reviewable upon appeal, it was reviewable here because the Board had not applied the correct legal principles in reaching its conclusion. Cf. *Powers* v. *Commissioner,* 312 U. S. 259.

The Board also relied on the fact that the beneficial owners advanced sums to the trust and pledged their individual credit for it (R. 20). Such voluntary action is hardly an indicium that an association was not created. Cf. *Commissioner* v. *Fortney Oil Co.,* 125 F. (2d) 995 (C. C. A. 6th); *Kilgallon* v. *Commissioner,* 96 F. (2d) 337 (C. C. A. 7th), certiorari denied, 305 U. S. 622. And the absence of such characteristics of corporate form as certificates of interest, appointment of officers and hiring of employees, relied on by the Board (R. 20), is also not controlling. *Morrissey* v.

Commissioner, supra; Swanson v. *Commissioner, supra; Helvering* v. *Coleman-Gilbert, supra; Commissioner* v. *Fortney Oil Co., supra.*

Point II of the taxpayer's brief in support of its petition (pp. 17–22) consists largely of the contention that the resemblance to a partnership is much greater here than the resemblance to an association. The taxpayer contends that denial of its status as an ordinary trust should be followed by a remand to the Board for findings on the partnership status. However, if the taxpayer is not a pure trust, there is even less room for a determination that it is a partnership. The provisions for continuity and limited liability deprive the entity of the two most significant indicia of a partnership.

CONCLUSION

The decision below is in accord with applicable decisions of this Court. It is respectfully submitted that the petition should be denied.

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